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No. 99-916

Supreme Court, U.S.
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IN THE
Supreme Court of the United States

ENRON POWER MARKETING, INC.,
Petitioner,

v.

NORTHERN STATES POWER CO., *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit and on Petitioner's Suggestion of Mootness and Motion to Vacate

PETITIONER'S REPLY TO RESPONDENTS' OPPOSITION

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38 pp

RULE 29.6 STATEMENT

Petitioner Enron Corp. incorporates by reference the Rule 29.6 Statement provided in its Petition for Writ of Certiorari filed on November 30, 1999.

TABLE OF CONTENTS

	Page
RULE 29.6 STATEMENT	i
TABLE OF AUTHORITIES	iv
ARGUMENT	1
CONCLUSION	9
APPENDICES:	
A. Letter from Bill Richardson, U.S. Secretary of Energy, to Tom Bliley, Chairman, House Committee on Commerce, U.S. House of Representatives (Jan. 11, 2000)	1a
B. Letter from James J. Hoecker, Chairman, FERC, to Tom Bliley, Chairman, House Committee on Commerce, U.S. House of Representatives (Dec. 23, 1999)	10a

TABLE OF AUTHORITIES

CASES	Page
FPC v. Conway Corp., 510 F.2d 1264 (D.C. Cir. 1975), *aff'd*, 426 U.S. 271 (1976)	5, 6
FPC v. Louisiana Power & Light Co., 404 U.S. 621 (1972)	6, 7
Mississippi River Transmission Corp. v. FERC, 969 F.2d 1215 (D.C. Cir. 1992)	6, 7
Northern States Power Co. v. FERC, 176 F.3d 1090 (8th Cir. 1999)	2, 3, 4
United States v. Munsingwear, 340 U.S. 36 (1950)	8

MISCELLANEOUS MATERIAL

Letter from Bill Richardson, U.S. Secretary of Energy, to Tom Bliley, Chairman, House Committee on Commerce, U.S. House of Representatives (Jan. 11, 2000)	2, 3
Letter from James J. Hoecker, Chairman, FERC, to Tom Bliley, Chairman, House Committee on Commerce, U.S. House of Representatives (Dec. 23, 1999)	3, 4, 5
Wright, Miller & Cooper, 13A Federal Practice and Procedure: Jurisdiction 2d § 3533.10	8

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PETITIONER'S REPLY TO RESPONDENTS' OPPOSITION

The Solicitor General's brief in opposition agrees with petitioner Enron that the Eighth Circuit decision is "wrong" (FERC Br. in Opp. 11, 14, 15, 16, 19); that the court "erred in its narrow view of the Commission's statutory jurisdiction" over electric power transmission (*id.* 15); that NSP's subsequent voluntary withdrawal of its tariff mooted the case (*id.* 11, 18); that petitioner did not cause the mootness (*id.* 18); and that if the Court agrees with petitioner that certiorari would have been warranted, the Court "should vacate the decision below." (*Id.* 19).

While the Solicitor General expresses "considerable sympathy for petitioner's desire to have the decision below vacated so as to eliminate any possibility that it will lead to the broadly adverse consequences petitioner fears" (*id.*), he nevertheless argues that the decision is not certworthy because FERC itself attempted a heroic "limiting construction" rather than seek review (*see id.* 16-17) and therefore vacatur is inappropriate. In fact, the decision is both important and otherwise certworthy, and vacatur is warranted.

Importance. The Solicitor General's position as to the significance of this case contrasts sharply with the position stated—after petitioner's prior filings in this Court and after the case was mooted by NSP—by both the Secretary of Energy and the Chairman of FERC. Both have written to Congress. Each noted that the Eighth Circuit ruled that FERC is powerless to protect interstate wholesale transmissions of power against discrimination in favor of bundled retail sales, and each stressed the precedential importance of that decision.

On January 11, 2000, Energy Secretary Richardson wrote to Chairman Bliley of the House Committee on Commerce, commenting on H.R. 2944, a pending bill that would change aspects of electric power regulation. He warned that the rule announced by the Eighth Circuit in this case would "balkanize" regulation with a "chaotic impact on the development of competitive markets":

> In *Northern States Power Co. v. FERC*, 176 F.3d 1090 (1999), the Eighth Circuit Court of Appeals held that FERC was essentially powerless to prevent a utility from using its ownership of transmission facilities that are used for bundled retail sales to favor its own retail customers over wholesale transmission customers. H.R. 2944 adopts the Eighth Circuit's line of reasoning, by explicitly providing

> that States, and not FERC, have sole jurisdiction over the transmission component of bundled retail sales.
>
> This provision is troubling. The regulation of transmission would essentially be balkanized, which could have a potentially chaotic impact on the development of competitive markets. FERC would be unable to prevent a utility providing bundled transmission services from gaining a competitive advantage over other electricity suppliers.[1]

Earlier, on December 23, 1999, FERC Chairman James J. Hoecker also wrote to Chairman Bliley criticizing H.R. 2944 for failing to correct the serious jurisdictional problems created by the Eighth Circuit's decision.

> H.R. 2944 fails to adequately address the jurisdictional problem evidenced by the Eighth Circuit's recent holding in *Northern States Power Co. v. FERC, (NSP)*, 176 F.3d 1090 (8th Cir. 1999). If the *NSP* case were to be interpreted and applied broadly, the Commission would be prevented from ensuring that interstate transmission services are provided without preference to any group of transmission users, such as the retail loads of any particular state, leading to balkanization of the national interstate transmission grid.[2]

The appendix to Chairman Hoecker's letter elaborates on the damaging effects of the decision below:

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[1] Letter from Bill Richardson, U.S. Secretary of Energy, to Tom Bliley, Chairman, House Committee on Commerce, U.S. House of Representatives, at 3 (Jan. 11, 2000); Appendix at 4a. The letters of Secretary Richardson and Chairman Hoecker are reprinted in full in the attached Appendix.

[2] Letter from James J. Hoecker, Chairman, FERC, to Tom Bliley, Chairman, House Committee on Commerce, U.S. House of Representatives, at 3 (Dec. 23, 1999); Appendix at 13a.

> [A] recent court decision has raised concerns about the Commission's ability to ensure non-discriminatory transmission service. The appellate court decision in *Northern States Power Co. v. FERC*, 176 F.3d 1090 (8th Cir. 1999), *(NSP)*, if interpreted and applied broadly, may allow the States to establish preferential terms and conditions for the bundled transmission services they regulate compared to the terms and conditions available to other transmission users. This would interfere with interstate commerce in electricity. While the Commission does not construe *NSP* this broadly, others may so argue and, in fact, have already begun doing so.[3]

FERC is sufficiently troubled by the Eighth Circuit decision to suggest legislative overruling. But there is a simpler solution than allowing the continued validity of the decision to affect the legislative process: vacatur on grounds of mootness, in accordance with this Court's established procedures.

Certworthiness. The Solicitor General has advised this Court that FERC "is not prepared at this point to endorse petitioner's arguments about the practical significance of the decision below" (FERC Br. in Opp. 16). His explanation is that FERC itself "had concluded that the Eighth Circuit's decision *could be* narrowly construed" (*id.* (emphasis added)) and, rather than seek review in this Court, FERC decided to try to narrow the decision in an administrative order FERC issued after remand.[4]

But the Solicitor General and FERC cannot whistle quite so easily past this particular graveyard. FERC Chairman Hoecker told Congress that the Eighth Circuit

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[3] Appendix at 18a.

[4] FERC's Order after remand was of course itself never subject to review, because NSP chose instead to withdraw its tariff and moot the case.

decision can be "interpreted and applied broadly" and that others "have already begun doing so." *See supra* p. 4. Chairman Hoecker's fears are justified: the central premise of the Eighth Circuit decision was that the curtailment practices FERC prescribed in Order No. 888 and imposed on NSP here conflict with state regulatory power—and that state power wins. The court said, "NSP, through FERC's interpretation, . . . will in effect be in violation of either a state tariff or Order No. 888." (Pet. App. 10a.) It therefore ordered FERC to amend its orders "so as not to encroach upon the regulatory authority of the states." (Pet. App. 11a).

As the Solicitor General acknowledges (FERC Br. in Opp. 15), the decision "is difficult, if not impossible, to reconcile with [the] principle" laid down by the D.C. Circuit and this Court in *Conway Corp. v. FPC*, 510 F.2d 1264 (D.C. Cir. 1975), *aff'd*, 426 U.S. 271, 272 (1976). Those decisions, as interpreted by the Solicitor General, hold that FERC "has plenary authority to regulate transactions within its jurisdiction even when the exercise of that authority affects other transactions within the regulatory jurisdiction of the States." (FERC Br. in Opp. 15). The Solicitor General sees "no merit to the court of appeals efforts to distinguish *Conway*." *Id.*[5]

The Solicitor General's brave attempt to limit the Eighth Circuit's decision to the facts of this case does not work. Although the case itself involved a particular "curtailment" policy, the decision below does not in any way *turn*

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[5] NSP argues that *Conway* holds only that FERC may "consider" price discrimination that indirectly affects services subject to FERC jurisdiction, but not that FERC may do anything about such discrimination. The Solicitor General correctly rejects this attempt to distinguish *Conway* because the key point is the same in both that case and this one: FERC may require that the jurisdictional rates not be set at levels that are unfair to the customers being charged those rates. *See Conway*, 426 U.S. 271, 272.

on aspects of that policy or other particular facts. It rests on the Eighth Circuit's belief, contrary to *Conway*, that FERC lacks power to protect jurisdictional interstate transmissions against discrimination in favor of retail customers. *See, e.g.*, Pet. App. 9a. The Eighth Circuit has thus rendered a decision that conflicts with decisions of this Court and the D.C. Circuit on a point of broad importance. The decision is binding on petitioner, FERC, and all other parties in the large area covered by the Eighth Circuit and has been cited to Congress and other courts. The decision would have warranted this Court's review on the merits had the case not been rendered moot, and it should be vacated now.[6]

Petitioner also made a separate argument, both below and in its petition in this Court, that FERC has direct jurisdiction over interstate transmission even when it is part of a bundled retail service, as this Court squarely held with respect to natural gas transmission in *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621 (1972). The Eighth Circuit decision cannot be squared with *Louisiana Power & Light*, and with the D.C. Circuit's decision in

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[6] NSP tries to portray Enron's position as attacking FERC's Order No. 888, NSP Br. in Opp. 6, 10-11. To the contrary, FERC's administrative ruling was *against* NSP, rejecting its tariff as not conforming to Order No. 888. In its petition to the Eighth Circuit for review, NSP argued that FERC lacked jurisdiction to prevent discrimination, a contention irreconcilable with the entirety of Order No. 888. Enron, and FERC both opposed this contention, citing *Conway*. The Eighth Circuit agreed with NSP and rejected the FERC/Enron position.

NSP's suggestion (Br. 12) that "this Court is without jurisdiction" because Enron failed to seek rehearing before FERC is another attempt to confuse the issue. Enron's position, supporting rejection of NSP's tariff, had prevailed in the FERC administrative proceedings and there was no need or obligation to "seek rehearing." The position taken by both FERC and Enron below assumed the validity of Order 888 and was in no sense a "collateral attack."

Mississippi River Transmission Corp. v. FERC, 969 F.2d 1215 (D.C. Cir. 1992). This conflict alone would have warranted review of the Eighth Circuit's decision by this Court, if this case were not moot.

FERC did not agree with Enron below on this point (nor did it agree in *Louisiana Power & Light* that it had parallel jurisdiction under the Natural Gas Act, but this Court told FERC that it did). FERC's brief in this Court argues that certiorari and vacatur are not warranted on this issue because the *Louisiana Power & Light* question has been raised and might be reached on the petitions for review of Order No. 888 that are pending before the D.C. Circuit. But the issue is one of many in that complex proceeding; there is no reason to assume that the D.C. Circuit will reach it. Moreover, the present question is not whether this Court should take up the issue on the merits in this case, but rather whether to vacate an unreviewable decision on a clearly important question. FERC's discussion of which case *would have been* a better vehicle if this case were not moot is therefore at best highly theoretical. The most practical course here, clearly, would be to vacate the Eighth Circuit decision so that the D.C. Circuit does not have to take that decision (and the possibility of a circuit conflict) needlessly into account in whatever it does.

In any event, the certworthiness of this case does not depend on the *Louisiana Power and Light* issue (i.e., whether FERC has jurisdiction over all interstate transmission of electricity). FERC and Enron agree that the Eighth Circuit erroneously decided the *Conway* issue (i.e., whether FERC can protect concededly jurisdictional transmissions against discrimination in favor of other transmissions). That issue is not before the D.C. Circuit. It should have been resolved by this Court in this case, had mootness not intervened.

The Munsingwear Doctrine. Petitioner believes that this case satisfies the suggested requirement, advanced by the United States but never expressly endorsed by this Court, that a decision must be independently certworthy before it may be vacated in accordance with *United States v. Munsingwear*, 340 U.S. 36 (1950). Petitioner also respectfully suggests that the Court need not wear such narrow and theoretical blinders as the Solicitor General is advocating in this case. The decision below is important, seriously wrong in the view of both petitioner and FERC, in conflict with decisions of this Court and other Circuits, potentially very mischievous in relation to future decisions in the Eighth Circuit and other Circuits and Congress, and now moot. Under those circumstances the Court does not in fact need to wrestle, on a wholly hypothetical basis, with questions like whether some other case might have provided a better vehicle to correct the error, or whether the Court should devote its own limited resources to a merits review. On the contrary, in a case like this one, vacatur is the most efficient way to leave the merits for future consideration: "The requirement that the Court undertake a hypothetical disposition of the petition would impose an unwarranted burden." Wright, Miller & Cooper, 13A Federal Practice and Procedure: Jurisdiction 2d § 3533.10, at 433 (1984).

CONCLUSION

For the reasons set forth above and in Enron's petition for writ of certiorari, the writ should be granted and the Court should vacate the decision of the Eighth Circuit and remand to that court with instructions to dismiss the case as moot.

Respectfully submitted,

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APPENDICES

APPENDIX A

THE SECRETARY OF ENERGY
Washington, DC 20585

January 11, 2000

The Honorable Tom Bliley
Chairman
Committee on Commerce
U.S. House of Representatives
Washington, D. C. 20515-6115

Dear Mr. Chairman:

Thank you for the letter you sent to the Department of Energy and other Federal agencies on November 30, 1999, requesting our analysis of H.R. 2944, the Electricity Competition and Reliability Act, as reported by the Subcommittee on Energy and Power. This response will provide the Administration's views on the bill.

It is crucial that the 106th Congress act on comprehensive electric restructuring legislation. As the States move forward with their individual retail competition programs, the absence of Federal legislation is creating significant uncertainty in regional power and transmission markets. This lack of certainty is having a direct impact on the reliability and efficiency of electric markets in both States that have adopted restructuring proposals and those that have not. If congressional action is further delayed, market participants will continue to be unable to plan adequately. State regulators and the Federal Energy Regulatory Commission (FERC) will remain without sufficient direction as to their appropriate regulatory roles, and the reliability of our electric grid may be endangered.

The Administration appreciates the courtesy shown us by Chairman Barton and the other members of the Subcommittee on Energy and Power as it considered restructuring legislation. The Subcommittee's process was open and fair and was conducted in good faith. Nevertheless, the legislation reported by the Subcommittee, H.R. 2944, fails to include many of the provisions necessary to promote more reliable, efficient and competitive markets and cannot be supported by the Administration in its current form. The remainder of this letter outlines our most serious objections.

Regional Transmission Organizations

Actual and perceived discriminatory conduct by transmission providers favoring their own power or power sold by an affiliate remains a significant impediment to the development of competitive markets. Potential participants may be inhibited from entering markets, and partilcularly from building new generation, if they believe that generators affiliated with transmission owners have an unfair advantage. Discriminatory treatment can also impair reliability because market participants may be reluctant to share information with transmission providers affiliated with competitors.

The Administration believes that truly independent regional transmission organizations (RTOs) are an effective remedy for this problem. RTOs can help promote more reliable, efficient and competitive power markets by eliminating a transmission-owning utility's ability to discriminate against competing power marketers and by removing many of the inefficiencies associated with the transmission of power across lines owned and operated by numerous entities.

H.R. 2944, while encouraging RTOs, relies on incentives and voluntary formation. We are concerned that some

transmission-owning utilities might be reluctant to give up the benefits they enjoy under the status quo in order to join an RTO. If some utilities decline to participate in an RTO or if different utilities in the same region join separate RTOs, many of the benefits associated with RTOs will be lost. FERC needs to have the authority to require RTO participation in order to promote the development of RTOs that are sensible in both structure and geographic scope.

H.R. 2944 also denies FERC the authority to require any change in an existing RTO, regardless of whether the organization meets the bill's standards or is the most effective organization for a particular region. This provision effectively removes a siginficant portion of the transmission system from FERC jurisdiction and fails to subject all transmission organizations to the same rules.

To be effective and unbiased, an RTO must be independent of all market participants. If the RTO is controlled by one or more market participants, it will have an incentive to favor its affiliates. Although H.R. 2944 nominally requires independence, it does not prohibit the affiliates of market participants from controlling an RTO. Control by an affiliate could equally compromise the RTO's independence. At the very least, there would continue to be the perception of discriminatory conduct.

The Administration is also concerned that the incentive pricing provisions in H.R. 2944 designed to encourage transmission-owning utilities to participate in an RTO may be ill-conceived. Certainly, any conditions that impede utility participation in RTOs need to be eliminated. However, it is important to recognize that, at least for the foreseeable future, transmission will continue to be a monopoly function. Transmission-owning utilities should not be permitted to recover an unjust amount at the ex-

pense of consumers. Likewise, it is counterintuitive to extend these incentives to pre-existing RTOs. The Commission may very well be in the position of allowing an existing RTO to increase rates without achieving any added value for consumers.

Bundled Transmission Services

H.R. 2944 would also makes it difficult for FERC to prevent a transmission-owning utility from engaging in discriminatory practices if the utility's transmission services are bundled with its generation and distribution activities. In *Northern States Power Co. v. FERC*, 176 F.3d 1090 (1999), the Eighth Circuit Court of Appeals held that FERC was essentially powerless to prevent a utility from using its ownership of transmission facilities that are used for bundled retail sales to favor its own retail customers over wholesale transmission customers. H.R. 2944 adopts the Eighth Circuit's line of reasoning, by explicitly providing that States, and not FERC, have sole jurisdiction over the transmission component of bundled retail sales.

This provision is troubling. The regulation of transmission would essentially be balkanized, which could have a potentially chaotic impact on the development of competitive markets. FERC would be unable to prevent a utility providing bundled transmission services from gaining a competitive advantage over other electricity suppliers. State regulators, which would have jurisdiction, may not have sufficient incentives to adequately police a utility's use of its transmission lines, especially if a competing supplier were seeking access to sell power to consumers located in another State.

Market Power

We are also disappointed that H.R. 2944 fails to address the issue of horizontal market power. Even if access to

transmission is sufficiently open, utilities with significant control over generation may be able to raise prices above competitive levels while inhibiting the entry of new market participants. The exercise of market power has the potential to cut, or even eliminate, the substantial savings to consumers that would otherwise result from competition in the wholesale and retail marketplaces.

Evidence from the United Kingdom, which recently restructured its electricity markets, is illuminating. The two companies operating coal-fired generating units were able to engage in strategic bidding behavior that raised prices above competitive levels—perhaps by as much as 25%—despite the entry of new participants in the market.

Because utilities have legally acquired their current monopoly status and control over generation under a previous regulatory regime, existing Federal law is inadequate to address this problem. Restructuring legislation should grant FERC the authority to remedy horizontal market power in wholesale markets. In addition, FERC should have the authority to mitigate retail market power if a State regulatory agency so requests.

Utility Mergers

We can expect that, as industry restructuring continues, the pace of mergers will continue to accelerate. While some mergers can produce economies and efficiencies for both utilities and consumers, it is important that FERC be able to ensure that mergers not inhibit the trend towards competitive markets.

H.R. 2944 requires FERC to act on a utility merger application within 180 days. If no action is taken in this time period, the merger is deemed automatically approved. Although it is important that merger reviews proceed on a timely basis, we are concerned that the deadline in-

cluded in the bill unreasonably restricts FERC's ability to review complex utility mergers. Utilities would have an incentive to delay the review process in the hope that the Commission could not meet the deadline.

In addition, H.R. 2944 fails to address the gaps that currently exist with regard to FERC's ability to review certain types of mergers pursuant to the Federal Power Act, Mergers between generation-only companies and utility holding companies can have a significant impact on a power marketer's ability to stunt the development of competitive markets. FERC's current authority over these transactions is uncertain. The Administration's proposed legislation provides FERC with authority to regulate these types of mergers as well.

Role of State Restructuring Programs

The Administration believes that it is appropriate for the States to take the lead on issues associated with the transition to retail competition. However, it is important to recognize that the Federal Government continues to have an important role to play in enhancing the reliability, efficiency, and competitiveness of interstate markets. Unfortunately, H.R. 2944 undermines this essential Federal role by prohibiting the application of the provisions of the bill where States adopt conflicting provisions as part of a retail competition plan, even if the plan is adopted as long as three years following the enactment of the bill. Federal restructuring legislation cannot succeed if the States are able to preempt the Federal role, regardless of the impact such preemption may have on interstate commerce.

Environmental Protection and Other Public Benefits

Although we recognize that H.R. 2944 includes a title on environmental protection, the bill does not go far enough

in addressing potential impacts on the environment. As both the President and the Vice President have stated on numerous occasions, and as is supported by the Supporting Analysis for the Comprehensive Electricity Competition Act published by the Department of Energy (May, 1999), economic growth and environmental protection need not be mutually exclusive. The Administration's legislation appropriately incorporates measures to protect the environment, including a renewables portfolio standard and a public benefits fund.

While competition has the potential to increase renewable energy's share of the electricity market, the inherent uncertainties associated with the transition to competition, the recognition of important environmental and energy diversification benefits from renewables, and the fact that existing Public Utility Regulatory Policies Act requirements are incompatible with competition and ineffective under present market conditions suggest that Federal policy towards renewable electricity should be revisited in the context of restructuring legislation.

H.R. 2944 provides inadequate incentives for the development of this important technology. We believe the adoption of a renewable portfolio standard provides more appropriate signals to support renewable energy investment decisions than the expansion of the Renewable Energy Production Incentive that is proposed in H.R. 2944.

In addition, we are concerned that the bill fails to provide support for other important public benefits programs. Under cost-of-service regulation, programs supporting and promoting research and development, energy efficiency and low-income assistance were supported, in part, through utility rate structures. As utilities prepare for competition, they will be unwilling to include in their rates the cost of programs not included in the rates of their

competitors. A public benefits fund, which provides matching grants to States for low-income assistance, energy efficiency programs, consumer education and the development and demonstration of emerging, clean technologies, should alleviate these concerns. The Administration's proposal also authorizes a rural safety net and other provisions designed to assure that Native Americans and persons living in rural areas share fully in the benefits associated with restructuring.

Federal Utilities

The Administration is pleased that H.R. 2944 includes provisions designed to enhance the opportunities for competition in the regions served by the Federal Power Marketing Administrations (PMAs) and the Tennessee Valley Authority (TVA). The bill adopts many of the changes proposed in our legislation, the Comprehensive Electricity Competition Act. We are concerned, however, that the provisions of H.R. 2944 which apply the antitrust laws to the PMAs may, at a minimum, need to be modified to ensure that the PMA activities currently permitted by statute are not inadvertently repealed.

Target Date/Opt-Out

While the Administration agrees with the premise of H.R. 2944 that States should take the lead in implementing retail competition programs, we continue to believe that there is substantial merit to establishing a target date for the implementation of retail competition and requiring State utility commissions and non-regulated municipal and cooperative utilities to hold proceedings to examine the benefits or costs of adopting retail competition programs. Most, if not all, State utility commissions and non-regulated utilities would likely determine that competition would benefit consumers in their jurisdictions after a thorough examination.

Federal Electricity Purchases

Like all consumers, the Federal Government expects to reduce its electricity bill in a competitive marketplace, thereby achieving savings for the Federal taxpayer. H.R. 2944, however, may allow utilities to discriminate against the Federal Government, in its role as consumer. The bill divests FERC of jurisdiction over all cases involving the Federal Government in which the Government received electric service as of July 1, 1999, under a retail tariff. This provision would deny Federal taxpayers the benefits of competitive markets. Moreover, its purpose is to resolve a pending legal dispute between the Department of Energy and a private utility. This legal dispute should be resolved in the proper forum; it should not be settled by a retroactive change in the law because a utility company may be nervous about its prospects for success under the current statutory language.

Mr. Chairman, the Administration appreciates this opportunity to comment on H.R. 2944 and look forward to working with you and other members of the Committee to enact comprehensive electricity restructuring legislation that promotes reliable, efficient, and competitive markets.

Yours sincerely,

/s/ Bill Richardson
BILL RICHARDSON

cc: The Honorable John D. Dingell
Ranking Minority Member

APPENDIX B

FEDERAL ENERGY REGULATORY COMMISSION
Washington, DC 20426

Office of the Chairman December 23, 1999

The Honorable Tom Bliley
Chairman
Committee on Commerce
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your letter of November 30, 1999, requesting my views on H.R. 2944 as reported by the Energy and Power Subcommittee of the House Commerce Committee. You note that the goal of legislation should be a seamless national market for electricity. I am pleased to have the opportunity to offer my personal views on the bill, particularly in light of the Commission's strong and continuing efforts to promote competitive and seamless bulk power markets.

Overall, I believe the current version of H.R. 2944 represents an unfortunate retreat from the goal of a competitive, efficient, and transparent wholesale power market, a goal that would be much better served by adoption of H.R. 2050 or H.R. 1828. In fact, H.R. 2944 moves in a direction that is contrary, not only to Commission policy, but to economic and operational developments in the marketplace itself. The growing significance of the interstate bulk power trade, new technologies, the entry of new participants in the market, and the arrival of futures contracts and e-commerce offer great potential benefits to consumers. However, the benefits that these changes bring to the energy economy can be thwarted by ineffi-

cient grid operations or by parochial and discriminatory practices by transmission owners. That is why the Commission is pursuing the development of regional markets and fair and open transmission access so vigorously. Competition will not survive in a balkanized environment with conflicting market rules, congestion, barriers to entry, vertically integrated utilities and, most importantly, declining reliability. Competition and monopoly power are simply incompatible.

The challenges we face in ensuring fair, efficient and reliable operation of the transmission grid and promoting truly competitive bulk power markets are fundamentally issues of interstate commerce. These are precisely the kinds of matters that the Federal Power Act and the Commission were created to solve. In fact, I believe that solutions at the federal (*i.e.*, interstate) level are now more necessary than ever before given the development of wholesale markets. States, of course, will continue to have a critical regulatory role. The vast majority of electricity transactions are retail—matters appropriately handled by our state courterparts. Retail consumers in all states, however, will benefit from open and competitive wholesale markets, regardless of whether they are allowed to participate directly in that competitive environment or whether their traditional utility providers participate in it on their behalf. H.R. 2944, in my view, both misses key opportunities to advance competition in interstate bulk power markets and, in some important respects, would set back the development of such competitive markets.

Not all the news is bad, I hasten to add. H.R. 2944 makes a positive contribution in these areas:

- Section 102 ratifies the Commission's open access rules (Order No. 888) and also places transmis-

sion service of public power entities, rural electric cooperatives, and Federal utilities under the Commission's jurisdiction.

- Section 103(a) endorses the Commission's view that Regional Transmission Organizations (RTOs) will improve interstate transmission and the reliability of bulk power markets.

- Section 201 establishes electric reliability organizations to develop enforceable reliability standards, subject to Commission review.

While I am heartened by these provisions, I find H.R. 2944 otherwise disappointing. To be as specific as possible, I submit with this letter two analyses in appendix form. One details the policy and legal issues raised by major provisions of H.R. 2944. The second provides specific language for revising the bill on these and other issues.

Let me summarize my principal problems with the bill:

- The bill leaves RTO participation entirely to the discretion of each utility. This arguably diminishes current authority under the Federal Power Act to take certain actions to cure undue discrimination in the provision of service by transmission-owning utilities, and leaves the Commission without tools to provide for RTO participation by public or cooperatively-owned transmitting utilities.

- The bill precludes the Commission from developing the standards that RTOs must meet, relying instead on limited statutory standards. The Commission's recent RTO Final Rule, Order No.

2000,[1] employs more elaborate and demanding standards, based on an extensive record developed in that proceeding.

- H.R. 2944 fails to adequately address the jurisdictional problem evidenced by the Eighth Circuit's recent holding in *Northern States Power Co. v. FERC* (*NSP*) 176 F.3d 1090 (8th Cir. 1999). If the *NSP* case were to be interpreted and applied broadly, the Commission would be prevented from ensuring that interstate transmission services are provided without preference to any group of transmission users, such as the retail loads of any particular state, leading to balkanization of the national interstate transmission grid.

- The bill allows States to exempt themselves from the requirements of H.R. 2944 during a three year period following enactment. This provision invites States to take actions that would further balkanize the Nation's transmission grid, and is not necessary to protect state prerogatives in regulating retail markets.

- The bill fails to extend Federal Power Act review to mergers involving only generation facilities, and requires the Commission to act on all merger applications within 180 days after the filing date. While the Commission typically acts within this time frame, a few complex mergers must be set for hearing, and it would be unfortunate if the Commission were forced to reject mergers simply because time ran out before the Applicant could demonstrate at such a hearing that disputes should be resolved in its favor.

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[1] The Commission issued Order No. 2000 on December 20, 1999 (*see* http://www.ferc.fed.us/newsl/rules/pages/rulemake.htm).

- The bill does not include explicit authority to address market power in wholesale markets through market power mitigation. If we cannot ensure fair competition, there will be no hope for light-handed regulation.

The appendices to this letter contain substantive support for my views, as well as recommended modifications to H.R. 2944 on other important issues. In that connection, I repeat my offer to you, Chairman Barton, and all members of the full Committee to furnish any technical support that may be needed to craft a sound legislative approach. I do believe that Congress should act to provide direction for the restructuring of this important industry. I also believe that the timing is propitious, especially with respect to RTOs and reliability. It is critical, however, that any federal legislation not perpetuate market inefficiency or balkanize the operation of the transmission grid. Flawed legislation will deny the American public the benefits of moving from vertically integrated monopolies to competition.

I hope that this information is helpful to you. If I can be of any further assistance in this or any other Commission matter, please let me know.

Sincerely,

/s/ James J. Hoecker
JAMES J. HOECKER
Chairman

Enclosures

Appendix A
Substantive Analysis of Major Issues

I. *Regional Transmission Organizations*

Section 103 of H.R. 2944 addresses regional transmission organizations (RTOs). Section 103(a) finds that RTOs "will improve the transmission of electric energy in interstate commerce and the reliability of the bulk-power system." The Commission shares this view on the value of RTOs to electricity consumers. However, I believe the provisions of section 103, as currently drafted, are inadequate to advance RTO formation, and in some respects are counter-productive.

First, H.R. 2944 leaves the decision to form or join an RTO in the sole discretion of transmission owners. I do not support this approach. While the Commission is taking a voluntary approach to formation of RTOs at this time, I do not believe transmission owners should be given discretion to stand as an obstacle to the benefits of RTOs indefinitely. As H.R. 2944 finds, RTOs "will improve the transmission of electric energy in interstate commerce and the reliability of the bulk-power system." I believe the benefits of RTOs also include: (1) removing remaining opportunities for discriminatory transmission practices; (2) improved market performance; and (3) facilitating necessary grid expansions. I interpret the FPA to allow the Commission to require public utilities to form or join RTOs when necessary to mitigate market power or remedy undue discrimination or anticompetitive effects. H.R. 2944 should be modified to reinforce, not undermine, this existing authority.

Second, participation in RTOs by all transmission-owning utilities, including non-public utilities, is likely to be critical to the success of RTOs. H.R. 2944 would au-

thorize the federal transmitting utilities to participate in RTOs, but would not authorize the Commission to require RTO participation by these or other non-public utilities. These utilities control significant portions of the interstate transmission grid. The Commission's authority to require formation of or participation in RTOs should extend to all transmitting utilities.

Third, H.R. 2944 appears to allow the Commission only to approve or disapprove an RTO application under Section 202(h), but not to modify it. To ensure that RTOs yield their expected benefits as soon as possible, and consistent with the Commission's authorities and practices under other FPA sections, such as sections 203, 205 and 206, the Commission should have the procedural flexibility to work with the applicants to modify a flawed proposal, instead of simply disapproving a deficient or non-complying application and thereby imposing the burden of repeated reapplication.

Fourth, H.R. 2944 states that the Commission "shall approve" an RTO application if it meets certain standards specified in the statute. Although the topics of the standards—independence, geographic scope and configuration, operational authority and expansion—are generally consistent with some of the key considerations identified in the Commission's Final Rule on RTOs, the bill would not appear to allow the Commission to specify additional standards that an Applicant must meet in order to obtain Commission approval. For example, the Commission's RTO rule requires an RTO to be responsible for short-term reliability and carry out other functions necessary for an independent and efficient RTO. I do not support legislation that would preclude the Commission from adopting additional requirements for obtaining RTO approval when such requirements are necessary to ensure

that the RTO provides reliable, efficient and nondiscriminatory transmission service.

In addition, I do not support legislation that codifies detailed prescriptions for each of the standards that an RTO must meet. Competitive markets will continue to evolve in ways that are difficult to predict. The Commission as well as the institutions we regulate need the ability to adapt to changing market conditions and to changing regional needs.

One aspect of H.R. 2944's RTO standards is particularly troublesome. The independence provision states that ownership of passive, non-voting interests, or ownership of five percent or less of the voting interests in an RTO, shall be "deemed" not to confer control over the RTO. This provision appears to create a statutory definition of independence that cannot be rebutted even where specific circumstances indicate that passive ownership by an individual market participant and/or its affiliates, or active ownership by market participants, could inappropriately influence the decisions of the RTO to the disadvantage of other market participants.

II. *Undue Discrimination and Comparability*

Section 101 of H.R. 2944 provides Commission jurisdiction over transmission used for unbundled retail sales, and gives the States authority over transmission used for bundled retail sales. I believe codification of FPA jurisdiction of unbundled transmission is appropriate, but that jurisdiction over bundled transmission must be reexamined.

Explicit codification of the Commission's jurisdiction over transmission used for unbundled retail sales is appropriate. This codification will settle an issue that is already the subject of litigation on appeal of Order No.

888 and will prevent future litigation in other cases that may raise the same issue. This codification also will ensure that all unbundled transmission is provided on a comparable basis and avoid balkanization of markets that could result from different transmission rules established by each State.

However, codification of State jurisdiction over bundled retail transmission is problematic. While the Commission accepted State jurisdiction over bundled retail transmission in its Order No. 888, interstate markets for electricity have grown substantially since then, and historical distinctions between retail and wholesale transmission have become obsolete. In addition, a recent court decision has raised concerns about the Commission's ability to ensure non-discriminatory transmission service. The appellate court decision in *Northern States Power Co. v. FERC*, 176 F.3d 1090 (8th Cir. 1999), (*NSP*), if interpreted and applied broadly, may allow the States to establish preferential terms and conditions for the bundled transmission services they regulate compared to the terms and conditions available to other transmission users. This would interfere with interstate commerce in electricity. While the Commission does not construe *NSP* this broadly, others may so argue and, in fact, have already begun doing so. In light of this court decision, codifying State jurisdiction over bundled retail transmission will result in unnecessary litigation and uncertainty and could lead to undue discrimination in transmission services.

Section 902 of H.R. 2944 would require the Commission to study whether State regulation of the transmission component of bundled retail sales results in unduly discriminatory transmission services and to submit a report to Congress, making recommendations on amendments to Federal law. Resolution of this important issue should not be deferred. The problem of balkanized transmission

services must be addressed now to avoid stifling competition in bulk power markets. As the Commission found in its Final Rule on RTOs, competition in these markets requires regionalization of access to transmission services. Market participants, now more than ever, are looking to the Commission to exercise authority over all transmission, to ensure non-discriminatory access to the grid. Allowing 48 different sets of rules for access to transmission services will discourage or prevent wholesale sellers from entering many markets, and will impede an efficient marketplace.

The simplest solution, and the solution most likely to ensure the development of full competition in interstate markets for electricity, is not to codify State jurisdiction over bundled retail transmission and instead to expressly extend FPA jurisdiction over all transmission, including what is now called bundled transmission. This approach would preclude preferences for bundled transmission services and prevent the balkanization of transmission access. This approach is not inconsistent with respecting the States' role in regulating retail markets. I support federal jurisdiction over bundled retail transmission only to ensure the continued growth of competition in interstate bulk power markets by preventing balkanization of transmission access and unnecessary litigation and uncertainty. Federal jurisdiction over bundled retail transmission would not infringe on State or local siting authority or interfere with States regulating retail sales adequately.

An alternative approach that addresses the *NSP* issue more narrowly is to add to the FPA a specific provision (*see* Appendix B) clarifying the Commission's preemptive authority to ensure that transmission services within its exclusive jurisdiction are provided on a basis that is comparable to, *i.e.*, no less favorable than, other transmission services provided by a transmitting utility. This second

approach, however, is likely to result in more litigation than my first suggestion, because disputes about discrimination by individual States will need to be resolved case-by-case. The costs of this litigation also may discourage sellers from entering certain markets, thus diminishing competition.

III. *Existing State Programs*

Section 107(b) of H.R. 2944 provides as follows:

> Nothing in this Act [H.R. 2944] nor any amendment to the Federal Power Act made by this Act preempts, overrides, or requires any change in the terms of any State retail access plan enacted, adopted, approved, promulgated or ordered prior to or within three years after the date of the enactment of this Act to the extent that such plan addresses matters within the jurisdiction of the State prior to the enactment of this Act.

The effect of this provision is difficult to predict. The provision takes the unusual step of "grandfathering" *future* actions by States. This provision could allow States to exempt themselves and in-state utilities permanently from various sections of H.R. 2944, including possibly the reliability section and the section subjecting municipal and cooperative utilities to open access transmission service. It also could allow States to adopt provisions or conditions inconsistent with the Act.

I recommend deleting this provision to avoid further balkanization of power markets. The statutory scheme of the FPA is based on the need for federal regulation of interstate commerce. As power markets have become increasingly regional in recent years, market participants have recognized the need for, and advocated, consistent transmission rules without regard to corporate and State

boundary lines. The Commission's Final Rule on RTOs is an effort to adapt transmission rules to these commercial changes. Section 107(b) would allow States to intrude on the federal responsibility for regulating interstate transmission and contravene the procompetitive regionalization of power markets by preserving, and even inviting, 48 different regimes for interstate electricity markets.

Importantly, federal regulation of interstate power markets is fully compatible with allowing States to decide whether and how to adopt retail competition. The Commission has accommodated diverse State efforts to implement retail competition, and has not impeded any such efforts. The Commission also has not interfered in any way with the decisions of those States that have *not* authorized retail competition. Thus, section 107(b) is not needed for the purpose of preserving State autonomy. Instead, it creates risks that regulatory balkanization will undermine the procompetitive goals of H.R. 2944.

IV. *Mergers*

Under FPA section 203, the Commission must review proposed mergers, acquisitions, and dispositions of jurisdictional facilities by public utilities, and must approve such transactions if they are consistent with the public interest. In evaluating the public interest, the Commission considers a transaction's effects on competition, rates, and regulation.

The Commission's jurisdiction over mergers is currently limited in certain ways. First, the Commission has no direct jurisdiction over transfers of generation facilities. It can review transactions involving a public utility only when they involve other facilities that are jurisdictional (such as transmission facilities or contracts for wholesale sales). Second, the Commission lacks direct jurisdiction over mergers of public utility holding companies that have

electric utility subsidiaries. While the Commission has construed such mergers to involve jurisdictional indirect mergers of public utility subsidiaries of the holding companies, or changes *in* control over the jurisdictional facilities of the public utility subsidiaries, the FPA is not explicit on this point.

Section 401 of H.R. 2944 leaves existing FPA Section 203 intact, except for the addition of a provision which requires the Commission to act on a proposed application within 180 days after the date of filing. I believe that H.R. 2944 should clarify that the Commission has jurisdiction over transactions involving only generation facilities and mergers of holding companies. I also believe the 180-day provision is unnecessary and detrimental. The Commission already processes most mergers within this time limit but must take more time for the few mergers requiring evidentiary hearings. Section 401 may prevent the Commission from providing adequate due process and developing an adequate evidentiary record to analyze competitive effects. Alternatively, the Commission may be forced to reject mergers if applicants do not have enough time to meet their burden of establishing an evidentiary record demonstrating that factual disputes should be resolved in their favor. I recommend deleting section 401.

V. *Market Power*

An important issue that deserves serious consideration by the Congress, and that is not addressed in H.R. 2944, is the need for additional regulatory tools to address market power problems. Without such tools, we risk losing the foundation necessary to support deregulated generation markets. Based on the Commission's experience with rapidly changing markets and corporate realignment, I now believe that the Commission needs enhanced remedial authorities if we are to achieve and maintain competitive power markets.

Bulk power markets are changing rapidly, as the Commission and many States continue to promote competition and move away from requiring cost-based power sales. The Commission's Final Rule on RTOs is a major step toward addressing the remaining obstacles to competition in bulk power markets. However, market power still exists. The Commission can prevent enhancement of market power when transactions require authorization under FPA section 203, but this remedy does not address preexisting market power. The Commission also can deny or revoke authorization for market-based wholesale rates, but this approach forces a return to cost-based rates, a result that does little or nothing to promote competition. Moreover, market participants are increasingly seeking the Commission's authorization for mechanisms such as regional power exchanges, and these mechanisms cannot develop properly if the Commission's only tool for addressing market power issues is to require cost-based rates. In order to accommodate, and indeed foster, the growth of these regional markets, the Commission needs ample tools for addressing market power.

Other pending legislation would enhance the Commission's authority to address market power outside the context of mergers. For example, the Administration's proposed bill, H.R. 1828, would allow the Commission to address market power in retail markets, if asked to do so by a state lacking adequate authority to address the problem. This authority is consistent with the Commission's policy of addressing a merger's effect on retail competition when states request Commission action and cite their own lack of authority. The Administration's bill would also give the Commission explicit authority to address market power in wholesale markets by requiring a public utility to file and implement a market power mitigation plan. H.R. 2050, which Congressmen Markey and Largent have sponsored, also contains provisions that would

allow mitigation of market power, to the benefit of competition and consumers. As the Commission moves toward light-handed regulation of rates, terms and conditions of power sales, its ability to monitor the market and to identify and address exercises of market power becomes more important. The Commission should have more flexibility in dealing with market power problems. I strongly believe the Commission needs this additional authority to ensure that competition benefits all consumers.